In the

United States Court of Appeals

For the Ninth Circuit

CLARK SQUIRE, Collector of Internal Revenue, *Appellant*,

v.

STUDENTS BOOK CORPORATION, *Appellee*.

No. 12756.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE CHARLES H. LEAVY, JUDGE

BRIEF OF APPELLEE

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BRIEF OF APPELLEE

Appellee concurs in the statements contained in appellant's brief relative to "Opinion below" and "jurisdiction".

I. QUESTION PRESENTED

Appellee submits that a more fair statement of the question presented is as follows:

Whether a business corporation fully owned by an exempt educational institution and carrying on the business of a college book store and campus restaurant, whose earnings are entirely devoted to the purposes of the ex-

empt owners of its stock, is exempt from federal income tax, under Sec. 101(6), of the Internal Revenue Code as being organized and operated exclusively for an educational purpose.

The lower court answered this question in the affirmative.

II. STATUTES INVOLVED

Appellee concurs with the statement contained in the brief of the appellant, relative to statutes and regulations involved.

III. STATEMENT OF THE CASE

Appellee concurs in the statement of the case, which appears in the brief of appellant, except to add the following:

By-Laws of Students Book Corporation, Article V, section 3 C, as amended September 21, 1933, require that all actions of the Board of Trustees be submitted to the President of the college for approval (R. 87-88, 57). Likewise, all actions of the governing body of the parent organization, A.S.S.C.W., are subject to the control of the President of the college and the Board of Regents, by the terms of Sec. 3, Article II, A.S.S.C.W. Constitution (R. 102). The comptroller of the college holds the fidelity bonds of the officers of the Students Book Corporation (R. 57-58) and the comptroller of the college, ex-officio, acts as treasurer of the book store. (Plaintiff's exhibits 10 and 11, R. 133, 136; R. 42.) The book store is located on land which was originally at the edge of the campus, but which is now completely surrounded by the college campus (R. 64).

IV. SUMMARY OF ARGUMENT

The Students Book Corporation is organized and operated solely for the purpose of furthering the educational functions of the State College of Washington. While in form it is a business corporation, actually its affairs are controlled by a board made up of representatives of the A.S.S.C.W., an exempt corporation, having an educational purpose, and representatives of the college Board of Regents. Its profits have been, and will continue to be used, exclusively for the benefit of the college. The president of the college has a veto over all actions of the governing board of the Students Book Corporation, and in every sense, it is organized and operated exclusively for an educational purpose. No part of its net earnings ever have, nor can in the future, inure to the benefit of any private individual or shareholder. It, therefore, meets the requirements for exemption under section 101 (6) of the Internal Revenue Code, and is entitled to exemption.

V. ARGUMENT OF APPELLEE

1. Exemption is Determined by the Destination of the Income

The Supreme Court of the United States, long ago, recognized that the exemption provided for from federal corporate income taxes, is applicable, notwithstanding that profits may be earned from commercial enterprises, if the destination of the profits is the support of a charity. In the case of *Trinidad v. Sagrada Orden De Predicadores*, 263 U. S. 578, 68 L. Ed. 458, the Supreme Court held that a corporation organized for religious and charitable purposes was exempt from income tax al-

though it earned profits from rents, dividends, interest, and the sale of wine and chocolate.

The court there said:

> "The defendant concedes that the plaintiff is organized and operated for religious, charitable and educational purposes and that no part of its net income inures to the benefit of any stockholer or individual, but contends that it is not 'operated exclusively' for those purposes, and therefore is not within the exception in the taxing act. Stated in another way, the contention is that the plaintiff is operated also for business and commercial purposes in that it uses its properties to produce income, and trades in wine, chocolate and other articles. In effect, the contention puts aside as immaterial the fact that the income from the properties is devoted exclusively to religious, charitable and educational purposes, and also the fact that the limited trading, if it can be called such, is purely incidental to the pursuit of those purposes, and is in no sense a distinct or external venture.
>
> "Whether the contention is well taken turns primarily on the meaning of the excepting clause, before quoted from the taxing act. Two matters apparent on the face of the clause go far towards settling its meaning. First, it recognizes that a corporation may be organized and operated exclusively for religious, charitable, scientific or educational purposes, and yet have a net income. Next, it says nothing about the source of the income, but makes the destination the ultimate test of exemption."

The decision of the U. S. Supreme Court, above quoted, has settled any question as to whether an exempt corporation may be operated exclusively for an exempt purpose notwithstanding that it earns income to be used for such purpose by a commercial operation. It should be noted that the decision of the U. S. Supreme Court occurred in 1924, and has been followed by numerous decisions of the lower federal courts, which will be cited hereafter in this brief.

Nevertheless, congress has not seen fit to change the wording of the exemption, although the Internal Revenue Code has been adopted subsequent to that time and numerous amendments have occurred in the tax laws. This is a direct holding that it is not the source of the income, but the destination, that is the ultimate test of exemption.

That decision settles the question that a corporation may be exempt notwithstanding that it earns income from a commercial venture.

Directly contrary to the reasoning of appellant and the Commissioner of Internal Revenue is the decision of the Second Circuit Court of Appeals, in the case of *Roche's Beach Inc. v. Commissioner of Internal Revenue*, 96 F. (2d) 776. In that case, Roche's Beach, Inc., was engaged in the commercial operation of a public bathing beach. All of its stock was bequeathed to testamentary trustees for the purpose of establishing a fund for the relief of destitute women and children, which was conceded to be a charitable purpose. The court held that notwithstanding that Roche's Beach, Inc., was a business corporation and carried on a commercial activity it was entitled to exemption under sub-section 6 of section 101 of the Internal Revenue Code (formerly designated section 103). In so holding, the court said:

> "To gain exemption under subdivision 6 of section 103, 26 U. S. C. A. § 103 (6) note, the petitioner must be a corporation 'organized and operated exclusively for * * * charitable * * * purposes * * * no part of the net earnings of which inures to the benefit of any private shareholder or individual.' This does not mean that to come within the exemption a corporation may not conduct business activities for profit. The destination of the income is more significant than its source. See *Trinidad*

v. Sagrada Orden, 263 U. S. 578, 44 S. Ct. 204, 68 L. Ed. 458; *Sand Springs Home v. Commissioner,* 6 B. T. A. 198, 214; Appeal of Unity School of Christianity, 4 B. T. A. 61 * * *.

"In our opinion the petitioner is entitled to exemption under section 103 (6) unless it must be held that this subdivision applies only to a corporation which directly dispenses charity and excludes one which merely produces income for a charity administered by another tax exempt organization. This precise question has not been argued by the parties, but it is necessarily suggested by the contrast between subdivisions 6 and 14 and must be determined to decide the meaning to be ascribed to the phrase 'organized and operated exclusively for charitable purposes.' Since subdivision 14 relates to corporations which feed a tax exempt organization, the implication might arise that no 'feeding' corporation except those there described was intended to be granted exemption. If so, then subdivision 6 must be confined to corporations which themselves perform religious, charitable, scientific, literary, or educational functions. But we do not think the implication should be pressed so far. Exemptions of income devoted to charity are begotten from motives of public policy and are not to be narrowly construed. *Helvering v. Bliss,* 293 U. S. 144, 150, 55 S. Ct. 17, 79 L. Ed. 246, 97 A. L. R. 207; *Harrison v. Barker Annuity Fund,* 7 Cir., 90 F. (2d) 286, 288; *Cochran v. Commissioner,* 4 Cir., 78 F. (2d) 176, 179; *Produce Exchange Stock Clearing Ass'n v. Helvering,* 2 Cir., 71 F. (2d) 142, 143. Subdivision 14 relates to corporations which hold title and collect income for any tax exempt organization, and such organizations include many which are not embraced within subdivision 6. Hence, the fact that subdivision 14, as we have construed it, does not include corporations which operate a business, should not lead to the conclusion that subdivision 6, which does refer to operating corporations, includes only those which directly dispense their funds for the limited purposes there stated. No reason is apparent to us why Congress should wish to deny exemption to a corporation organized and operated exclusively to feed a charitable purpose when it undoubtedly grants it if the

corporation itself administers the charity. We think the language is adequate to describe both types * * *.

"For the foregoing reasons we believe the petitioner was entitled to exemption and the order of the Board should be, and is, reversed."

2. Students Book Corporation Performs an Educational Function.

Students Book Corporation is performing an essential function in connection with the operation of the educational activities of the State College of Washington.

College students must have books and other student supplies to enable them to pursue their studies, and it is essential that these be stocked in coordination with the college. If this service were not supplied by an agency such as the Students Book Corporation it would have to be furnished by the college itself, because the function is essential to the college operation. We think that if the college performed the function the income would be clearly exempt from taxation, notwithstanding that a charge might be made for the items.

The furnishing of text books and students' supplies we submit is an essential part of the educational activities of the college.

The activity of Students Book Corporation is carried on under the complete control of the college.

It will be noted that even before 1947, when the stock of the corporation was transferred to the Board of Regents of the college (R. 118-120), by Article 5, sec. 3 (c) of the Book Corporation's By-Laws (R. 87-88), all actions of its Board of Trustees were subject to approval by the president of the State College. Likewise, by the Constitution of the A.S.S.C.W., its actions were subject to

the college president's approval (R. 102). This control of the college officials over the affairs of the Book Corporation comes from their positions with the college, not their personal activities.

In this case, the Students Book Corporation performs functions essential to the educational activities of the college, and its ultimate control is, and has been, in the Board of Regents of the college. Its primary function is, therefore, educational. It is not simply a merchandising activity, but in effect, is the supply department of the college's educational activities.

The profits of the Students Book Corporation have inured, and shall continue to inure, to the benefit of the college (R. 14-18). The greater part of these profits has gone to the Student Union Building Project, which will become the property of the State of Washington when completed (R. 19, R. 69, R. 14).

When an exempt function is being performed by a corporation, and its profits are devoted to that purpose, it makes no difference that it also carries on commercial activities. It is true that there is some sale of merchandise to the general public (R. 18). However, that does not deprive a corporation, whose profits inure to the benefit of its exempt purpose, from its exemption. In the case of *Debs Memorial Radio Fund v. Commissioner of Internal Revenue*, 148 F. 2d 948 (2d Cir.), decided in 1945, the court considered the tax status of a corporation organized under the stock corporation laws of the State of New York, to engage in the business of broadcasting. The corporation was the successor to an organization formed for the purpose of conducting a free public radio forum for the dissemination of liberal and progressive

social views, and it was found that the corporation, formed in order to limit the personal liability of individuals responsible for the operation of the radio station, had adhered to the welfare purpose in the conduct of the corporate business. However, it was shown that the corporation carried on an extensive commercial broadcasting business, selling radio time to advertisers. The court said:

> " * * * Nor is it fatal to exemption that substantially all of the petitioner's income is derived from commercial activities since the purpose of making profits has been to enable it to broadcast its educational, civic and cultural programs without charge. * * * "

The court went on then to cite numerous authorities and said:

> " * * * In each of these cases, the taxpayer derived very large revenues from business activities but nevertheless was granted exemption under a clause similar to or identical with the one now under consideration. Consistently with these authorities we think the petitioner was 'operated exclusively for the promotion of social welfare.' The purpose of its commercial broadcasts has been to obtain funds to enable it to broadcast its educational, civic and cultural programs without charge * * *."

It will be noted that the court there held, that notwithstanding that the corporation in question carried on a commercial business, it could nevertheless be regarded as operated exclusively for an exempt purpose, since the destination of its income was the promotion of that purpose. In the same vein, the Circuit Court of Appeals for the second circuit, held in the case of *Bohemian Gymnastic Ass'n Sokol of City of New York v. Higgins,* 147 F. (2d) 774 (1945), that a membership corporation organized for educational purposes in giving athletic instruc-

tion, was entitled to exemption from federal social security taxes as an educational institution no part of the net earnings of which inured to the benefit of any private shareholder or individual.

This result was arrived at, notwithstanding that a substantial part of the earnings of the institution came from the profits of a restaurant and a bar. The court said:

> "* * * In the case at bar the ultimate object to which the corporate income is devoted is to promote education. To that end all funds of the corporation, including membership dues, as well as the profits derived from the bar and restaurant and the receipts obtained from renting out the bowling alley, gymnasium or other parts of the building were destined. Therefore, Bohemian is exempt from the Social Security Tax claimed by the Collector unless the income from the bar and restaurant inured to 'the benefit of any private shareholder or individual' within the meaning of Section 1426 (b) (8) supra."

The court then considered the question of whether the fact that its members benefited from the corporate activities took it outside the exemption.

The court said:

> "* * * We have construed statutory exemptions somewhat narrowly in the case of social clubs and have treated income derived by them from outside sources, if considerable in amount and recurrent, as destroying the exemption. But in the case of educational or charitable corporations the exemption is construed boardly as we held that it should be in Roche's Beach, Inc. v. Commissioner, 96 F. 2d 776, 779, supra. See also Helvering v. Bliss, 193 U. S. 144, 150, 55 S. Ct. 17, 79 L. Ed. 246, 95 A. L. R. 207; Jones v. Better Business Bureau of Oklahoma City, 10 Cir., 123 F. 2d 767, 769; United States v. Proprietors of Social Law Library, 1 Cir., 102 F. 2d 481, 482. If so construed, the words 'inure to the benefit' would, we think, require some benefit other than mere membership and a possible reduction in the amount of dues

contributed to the very educational or charitable objects for which the corporation was organized. * * *"

The reasoning of that case is applicable to the present situation. The bookstore performs a function for the college by supplying students with their tools of instruction, that is, their books and student supplies. The income derived from the activities of the bookstore corporation all go to the advancement of the educational institution. The fact that the bookstore makes profits is, we submit, incidental to its purpose, which is to make available the supplies which the students must have to carry on their educational pursuits.

Since the bookstore carries out an educational purpose the exemption should not be narrowly construed.

Under the authority of the cases cited in the foregoing quotations the destination of the income is the test, and if its destination is advancement of an educational purpose, the exemption may be liberally construed.

In the case of *Harrison v. Barker Annuity Fund*, 90 F. (2d) 286, the Circuit Court of Appeals for the 7th circuit, in speaking of the same exemption section as we now have under consideration, said:

> "The statute, section 103 of the Internal Revenue Act of 1928 (26 U. S. C. A., § 103 and note), provides that corporations of foundations organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals shall be exempt from taxation. Under this law, in view of the fact that bequests for public purposes operate in aid of good government and perform by private means what ultimately would fall upon the public, exemption from taxation is not so much a matter of grace or favor as rather an act of public justice. The reason for the rule of narrow scrutiny of a statute does not apply to such cases * * *."

The use of the income of the Students Book Corporation to provide a Student Union building, title to which will inure in the State of Washington, is a patent example of what the court was referring to in the quotation just set out when it spoke of such corporations performing a service that would ultimately fall upon the public otherwise. The taxpayers of the State of Washington are relieved from the obligation of purchasing the land and constructing a Student Union building.

3. The Form of Plaintiff's Corporate Charter Does Not Defeat Exemption.

It makes no difference in the present case that the Charter of the Students Book Corporation is in form such that it could engage in a general commercial business. The test for the purposes of exemption from income taxes is the purpose for which it is organized and operated, and that is not conclusively established by the language of the corporate charter.

In the case of *Appeal of Unity School of Christianity*, 4 B. T. A. 61, the Board of Tax Appeals discussed such a problem and said:

> "It is said that the fact that the incorporation was under the business law is indicative of its commercial purpose. This might be significant if not otherwise explained, but it is not conclusive. A corporation so organized is not, merely because it is permitted thereby to engage in business, precluded from an exclusively charitable purpose. The purpose of its organization and operation is still a question of fact, and the evidence may be such as to show that its purpose was charitable despite the ordinary implications of the statute under which it was created.
>
> "The suggestion also arises that the stated purposes expressed in the charter are entirely consistent with a corporation to be conducted for private gain—

that a school or a sanitarium is not necessarily charitable or non-profitable. And this, indeed, is true. By its charter this corporation might lawfully have been used as the means of increasing the wealth of its founders and stockholders. But the evidence is all to the effect that this was never the purpose or intent and has not been the effect. Looking to the purpose, as the statute requires, it becomes a question again of fact, as disclosed by evidence, and this is not determined by what might otherwise have been consistent with the charter.

"In considering whether a corporation is religious, charitable or educational, we must always be guided by the character of the organization and its activities. * * * Congress left open the door of tax exemption to all corporations meeting the test, the restriction being not as to the species of religion, charity, science or education under which they might operate, but as to the use of its profits and the exclusive purpose of its existence."

This holding was approved by the Circuit Court of Appeals in the case of *Roche's Beach Inc. v. Commissioner of Internal Revenue*, 96 F. (2d) 776. To the same effect see *U. S. v. Pickwick Electric Membership Corporation* (6 Cir.) 158 F. (2d) 272. Thus, in the present case, the court should be guided by the facts as to the purpose of the organization and operation of the Students Book Corporation, rather than by the mere language of its corporate charter.

4. Students Book Corporation is Integrated with Exempt Activities.

Plaintiff's original capital came from the Associated Students of the State College of Washington (R. 12), an exempt institution which, in turn, was organized and operated under the authority and control of the Board of Regents of the State College of Washington (See Article 2, Const. A.S.S.C.W.) (R. 101).

The Students Book Corporation is, and always has been, a wholly owned subsidiary, either of the Associated Students, State College of Washington, or of the Board of Regents. (R. 13, R. 19, R. 49.) At all times it has been completely under the control of these agencies, and has been operated solely for their purposes, and in accordance with their directions (R. 71).

Its profits have inured to their benefit, and have been paid at their call, and have been used for purposes dictated by them (R. 69, R. 13-16).

All pecuniary benefit from the stock of this corporation has gone to the Associated Students and the State College (R. 14, R. 69). In fact, Students Book Corporation, while in form an independent entity, has always been the creature of those agencies. In fact, it has not been operated as an independent instrument for private profit (R. 66-68). In this case, Students Book Corporation is a subsidiary of the Associated Students, which in turn, is a subsidiary of the State College. They all contribute to the general educational purpose of the college.

In the case of *Commissioner of Internal Revenue v. Orton*, (6 Cir.) 173 F. (2d) 483, the 6th Circuit Court of Appeals held that an organization performing an educational function was entitled to an exemption, notwithstanding that its activities produced income through the sale of ceramic products.

The court said:

> "The fact that the agency is productive is not alone controlling. In *Roche's Beach, Inc. v. Com'r*, 2 Cir., 96 F. 2d 776, 778, the court said:
>
> " 'This does not mean that to come within the exemption a corporation may not conduct business activities for profit. The destination of the income is more significant than its source. * * * '

"And it cited the *Trinidad* case and two cases from the Board of Tax Appeals, to wit: *Sand Springs Home v. Com'r*, 6 B. T. A. 198, 214; *Appeal of Unity School of Christianity*, 4 B. T. A. 61; see also *Debs Memorial Radio Fund, Inc., v. Com'r*, 2 Cir., 148 F. 2d 948, 951; *United States v. Pickwick Elec. Membership Corp.*, 6 Cir., 158 F. 2d 272; *Bohemian Gymnastic Ass'n Sokol of City of New York v. Higgins*, 2 Cir., 147 F. 2d 774.

"We think that in the case before us the exemption clause of the statute should not be narrowly construed."

The case just cited is similar to the present one, in that the operation actually carried on tended to make a profit, but the ultimate end of the operation and the destination of the profits was for an educational purpose.

The actual operation of a corporation and the actual purpose for which it is formed governs, rather than the mere form of its corporate organization.

In the case of the *United States v. Pickwick Electric Membership Corporation*, 6 Cir., 158 F. (2d) 272, the 6th Circuit Court of Appeals said:

"* * * The actual purpose is not controlled by the corporate form or by the commercial aspect of the business transacted, but may be shown by extrinsic evidence, including the by-laws and the method of operation. *Debs Memorial Radio Fund v. Commissioner*, *supra*. * * *"

In the present case there are no members of the Students Book Corporation who individually profit from its operations. Its stock was formerly held by the Associated Students, and now is held in trust by the college Board of Regents to be used for purposes for which the Associated Students was organized (R. 24-25).

There is virtually no way in which its earnings could ever inure to the benefit of any private individual. There are no private stockholders (R. 49).

The fact that the Associated Students of Washington State College might at some time be dissolved, and there might be some disposition of its assets, is a remote contingency indeed, in view of the type of institution with which we are dealing.

The membership in the Associated Students is subject to constant change, as students enter and graduate from the college since regular membership is limited to under-graduate students (See A.S.S.C.W. By-Laws, Article 2, R. 137, R. 102).

The A.S.S.C.W. is simply not the type of institution that is likely ever to be so liquidated that its assets would be divided among its members. Particularly is this true since, by the recital in Article II, section 1 of its constitution, it exists solely under the authority of the Board of Regents, who would have full control of any such dissolution.

At any rate, the fact that the assets of the A.S.S.C.W. are increased by the profits of the book store does not mean that there is a profit to the individual members within the meaning of the exemption statute.

In the case of *United States v. Pickwick Electric Membership Corporation*, 158 F. (2d) 272, the 6th Circuit Court of Appeals said:

> "* * * The fact that the members may receive some benefit on dissolution upon distribution of the assets is a contingency too remote to have any material bearing upon the question where the association is admittedly not a scheme to avoid taxation and its good faith and honesty of purpose is not challenged. *Crooks v. Kansas City Hay Dealers Ass'n, supra*, 8 Cir., 37 F. 2d 83, at page 87."

The Supreme Court of the United States has held that where one corporation is fully owned and controlled

by another, the two may be treated together for income tax purposes.

In the case of *Southern Pacific Company v. Lowe*, 247 U. S. 330, 62 L. Ed. 1142, the court held that the earnings of a wholly owned subsidiary were actually the earnings of the parent corporation, saying:

> " * * * While the two companies were separate legal entities, yet in fact, and for all practical purposes they were merged, the former being but a part of the latter, acting merely as its agent and subject in all things to its proper direction and control. And, besides, the funds represented by the dividends were in the actual possession and control of the Southern Pacific as well before as after the declaration of the dividends. * * * "

The situation is exactly the one found in this case, because the Associated Students or the Board of Regents have at all times appointed the Board of Directors of Students Book Corporation, and have used it to serve their lawful purposes. Its dividends have been paid upon the call of the parent entity to serve its purposes.

Students Book Corporation and the Associated Students were engaged in one single enterprise aimed at serving the students of the college and bringing about the erection of the Student Union building for the benefit of the college. Their activities were so intertwined and inter-related, that notwithstanding their separate corporate entities, it was really only one activity.

Under such circumstances, the Supreme Court of the United States, in the case of *Gulf Oil Corporation v. Llewellyn*, 248 U. S. 71, 63 L. Ed. 133, said:

> " * * * It is true that the petitioner and its subsidiaries were distinct beings in contemplation of law, but the facts that they were related as parts of one enterprise, all owned by the petitioner, that the

> debts were all enterprise debts due to members, and that the dividends represented earnings that had been made in former years and that practically had been converted into capital, unite to convince us that the transaction should be regarded as bookkeeping rather than as 'dividends declared and paid in the ordinary course by a corporation.' *Lynch v. Hornby,* 247 U. S. 339, 346. The petitioner did not itself do the business of its subsidiaries and have possession of their property as in *Southern Pacific Co. v. Lowe,* 247 U. S. 330, but the principle of that case must be taken to cover this. * * * "

Thus, the Supreme Court of the United States has recognized that where a common enterprise is engaged in by two corporations, and one controls the other, the earnings of the subsidiary are considered the earnings of the principal corporation notwithstanding that the business of the subsidiary may be a separate phase of the enterprise than that carried on by the principal. So in the present case, notwithstanding that the book store is carrying on the merchandising part of the common enterprise of the college, the Associated Students and the book store, its activities must be regarded as a part of the whole.

The situation in this case is in striking contrast to situations in two other cases cited by appellant. The first of these is *Bear Gulch Water Company v. Commissioner of Internal Revenue,* 116 F. (2d) 975, where an exemption was denied by this court to a corporation whose stock was wholly owned by the Board of Regents of the University of California. The corporation in that case was engaged in the business of supplying water to several communities on the opposite side of San Francisco Bay from the college. The court pointed out that the college was not served by the company. The court further pointed out that no dividends were declared by the company and said:

"* * * Thus it is clear that in 1933 no part of petitioner's income accrued to Regents. For although Regents was petitioner's sole stockholder, petitioner's income was not Regents' income and did not accrue to Regents until a dividend payable therefrom was declared by petitioner. * * *

"There was no finding nor any evidence warranting a finding that petitioner was merged with or became a part of Regents * * * or the petitioner and Regents were parts of one enterprise. * * *."

That case is wholly unlike this. The regents there were simply investors in a business which itself had no connection with the educational activities of the college. For the tax year in question the income of the Water Company had not gone to the college, and there was no showing as to the destination of the income. The Water Company was not organized nor operated for the educational purpose, and it was not even shown that any income from it had accrued to the college. In all of those respects the case is different from the one now before the court.

The other case cited by appellants is one involving a college book store. That is the case of *Stanford University Book Store v. Helvering,* 83 F. (2d) 710, decided in 1936. But the situation presented was entirely different from that presented in this case.

The facts there were that the book store was a membership corporation, which students could join upon the payment of $1.00. Such membership entitled the student to convert his receipts for purchases into dividends in the form of periodic rebates. The earnings thus accrued directly to the benefit of private individuals.

The court specifically found:

"* * * The university as such does not own

> any interest in the association, is not responsible for its debts, is not entitled to any part of its earnings, and takes no part in conducting and managing its affairs. The two institutions are separate legal entities and therefore the attributes of the university cannot be attributed to the association, nor can the latter claim to be an educational institution because the university is such. The members of the faculty of the university, as such, were not charged with the duty of conducting the affairs of the association."

The court found that the Stanford Book Store was simply an independent merchandising establishment, its net earnings inured to the profit of its members. The facts were, that all of its earnings, except those required for operation, and a contingency reserve, were divided among its members. That case is in striking contrast with the present one, where the book store, even prior to 1947, was a wholly owned subsidiary of the Associated Students, which in turn was subject to the supervision of the administration of the college and the Board of Regents.

Subsequent to 1947, the book store itself has been wholly controlled through the stock ownership of the Board of Regents of the college.

In the Stanford case, the University was not entitled to any of the earnings of the book store.

In the present case, virtually all of the earnings of the book store have actually inured to the benefit of the University through the purchase of land and the construction of a Student Union building, title to which will vest in the University.

In the present case there are no members of the Book Store Corporation, and there have never been any rebates or dividends accruing to anyone personally, but on the contrary, all the profits of the book store have accrued to the benefit of the college and its educational purpose.

With the stock all held by the Board of Regents and no control vested in the A.S.S.C.W., except to enforce the trust, there is no way in which the members of the Associated Students could require or bring about rebates, or the declaration of dividends, which would accrue to them as private individuals.

In the *Stanford* case, the court found that the members of the University faculty, as such, were not charged with the duty of conducting the affairs of the association.

The opposite is true in the present case, where the President of the college has a veto over all actions of the governing board of Students Book Corporation, and the comptroller of the college acts as Treasurer of the Book Corporation.

These responsibilities they exercise in their official capacities; not in their personal capacities, as in the case of the Stanford Book Store.

The Book Store at the State College of Washington is in every sense integrated with the educational activities of the college. It furnishes a service essential to such activities and such profits as arise from its operations accrue directly to the benefit of the college.

In this case the control of the President and the Board of Regents is a matter of their legal right under the By-Laws of Students Book Corporation, the By-Laws and Constitution of the A.S.S.C.W. and the trust agreement under which the Board of Regents holds the stock of Students Book Corporation.

This was unlike the situation in the Montana Students' Store case, cited by appellant, where the control was permissive rather than based upon any legal rights. In this case, the Associated Students itself, by its organic

articles, acknowledges that it exists only under the authority of the Board of Regents, and that organization has actually turned over the ownership and control of the bookstore stock to the Regents, and has put the relationship between the store and the college upon a definite legal basis.

Appellants, in their brief, have cited such cases as *Better Business Bureau v. United States,* 326 U. S. 279; *Universal Oil Products Company v. Campbell,* 181 F. (2d) 451, *Underwriters' Laboratories v. Commissioner,* 135 F. (2d) 371 and *Smythe v. California State Automobile Dealers Association,* 175 F. (2d) 752, as cases in conflict with the decision of the lower court in this case.

An examination of those cases will show they merely hold that organizations, having for their primary purpose the advancement of the profit making activities of their members do not qualify as educational institutions under the exemption statute simply because they carry on some instructional function. Those cases have no bearing upon this type of situation, where the activity of the principal is concededly educational, and the business corporation is carrying on a function which contributes, both materially, through furnishing an essential service, and financially, through supporting the State College in its activities, to the general educational purpose.

VI. CONCLUSION

The Students' Book Corporation is the creature of exempt institutions. It operates solely to serve their purposes and to contribute its earnings to their support. It furnishes a service essential to the educational activities of the State College of Washington, and in the truest sense, is an educational activity.

Its earnings do not inure to the benefit of any private individual or shareholder, but become the property of the State of Washington, through investment in college land and buildings.

The Students Book Corporation is controlled completely by the Board of Regents, and the President of the State College, and is only incidentally a profit making activity.

It is truly organized and operated exclusively for an educational purpose, and no part of its net earnings inure to the benefit of any private individual or shareholder. As such, it is entitled to exemption.

Respectfully submitted,

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